BEFORE THE
PUBLIC SERVICE COMMISSION OF
SOUTH CAROLINA

APPLICATION OF PALMETTO WASTEWATER RECLAMATION, INC. FOR AN ADJUSTMENT OF ITS RATES AND CHARGES	)))))	**Docket No. 2021-153-S**

DIRECT TESTIMONY

OF

LAFAYETTE K. MORGAN, JR.

ON BEHALF OF THE

SC DEPARTMENT OF CONSUMER AFFAIRS

September 30, 2021

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I. INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Lafayette K. Morgan Jr. My business address is 10480 Little Patuxent Parkway, Suite 300, Columbia, Maryland, 21044. I am a Public Utilities Consultant working with Exeter Associates, Inc. ("Exeter"). Exeter is a consulting firm specializing in issues pertaining to public utilities.

Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND QUALIFICATIONS.

A. I received a Master of Business Administration degree with concentration in Finance from The George Washington University. I also have a Bachelor of Business Administration degree with concentration in Accounting from North Carolina Central University. I was previously a CPA licensed in the state of North Carolina. In 2009, I elected to place my license in an inactive status as I focused on other business interests.

Q. PLEASE DESCRIBE YOUR PROFESSIONAL EXPERIENCE.

A. From May 1984 until June 1990, I was employed by the North Carolina Utilities Commission - Public Staff in Raleigh, North Carolina. I was responsible for analyzing testimony, exhibits, and other data presented by parties before the North Carolina Utilities Commission. I examined the books and records of utilities involved in rate proceedings and summarized the results into testimony and exhibits for presentation before that Commission. I was also involved in numerous special projects, including compliance and prudence audits of a major utility and research on issues affecting natural gas and electric utilities.

From June 1990 until July 1993, I was employed by Potomac Electric Power Company ("Pepco") in Washington, D.C. At Pepco, I prepared cost of service, rate base and ratemaking adjustments supporting the company's requests for revenue increases in the State of Maryland and the District of Columbia.

From July 1993 through 2010, I was employed by Exeter as a Senior Regulatory Analyst. During that period, I analyzed the operations of public utilities, with emphasis on utility rate regulation, including general rate cases, proceedings on pass-through costs or cost savings, assisting with rate negotiations for large customers, and reviewing cost recovery mechanisms. I reviewed and analyzed utility rate filings, focusing primarily on revenue requirements determinations. This work involved natural gas, water, electric and telephone companies.

In 2010, I left Exeter to focus on start-up activities for other business interests. In late 2014, I returned to Exeter to continue to work in a capacity similar to my work during the period 1993-2010.

Q. HAVE YOU PREVIOUSLY TESTIFIED IN REGULATORY PROCEEDINGS ON UTILITY RATES?

A. Yes. I have previously presented testimony and affidavits on numerous occasions before the Colorado Public Utilities Commission; the Georgia Public Service Commission; the Illinois Commerce Commission, the Kansas Corporation Commission; the Kentucky Public Service Commission; the Louisiana Public Service Commission; the Maine Public Utilities Commission; the Maryland Public Service Commission; the North Carolina Utilities Commission; the Corporation Commission of Oklahoma; the Pennsylvania Public Utility Commission; the Philadelphia Water, Sewer and Storm Water Rate Board; the Philadelphia Gas Commission; the Public Utilities Commission of Rhode Island; the Public Service Commission of South Carolina; the Vermont Public Service Board; the Virginia Corporation Commission; the West Virginia Public Service Commission; and the Federal Energy Regulatory Commission. My resume is attached hereto as Appendix A.

Q. ON WHOSE BEHALF ARE YOU APPEARING?

A. I am presenting testimony on behalf of the South Carolina Department of Consumer Affairs ("DCA").

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A. Exeter has been retained by the DCA to assist in the evaluation of Palmetto Wastewater Reclamation, Inc.'s ("PWR" or "Company") application to increase its rates and charges. The scope of my assistance is to determine the increase in the level of revenues that PWR should be authorized in this proceeding. In this testimony, I present my findings regarding PWR's test year rate base and net operating income at present rates. Based on these amounts, I have determined the revenues that are required to generate the overall rate of return on rate base of 5.22 percent based upon the 7.31 percent return on equity as recommended by DCA witness Aaron Rothschild.

Q. HAVE YOU PERFORMED AN EXAMINATION AND REVIEW OF THE COMPANY'S TESTIMONY AND EXHIBITS?

A. Yes. I have reviewed PWR's testimony, exhibits and its rate filing. I have also reviewed the Company's responses to data requests served by the DCA and The Office of Regulatory Staff ("ORS").

Q. HAVE YOU PREPARED SCHEDULES TO ACCOMPANY YOUR TESTIMONY?

A. Yes. I have prepared Schedules LKM-1 through LKM-12. Schedule LKM-1 provides a summary of revenues and expenses under present and proposed rates. Schedule LKM-2 summarizes my adjustments to PWR's test year rate base. Schedule LKM-3 provides a summary of my adjustments to test year revenues and expenses and the resulting operating income. My adjustments to PWR's claimed revenues and operating expenses are presented on Schedules LKM-5 through LKM-12. My Schedules are attached hereto as Exhibit 1.

II. SUMMARY AND RECOMMENDATIONS

Q. PLEASE SUMMARIZE THE RATE RELIEF REQUESTED BY PWR IN ITS FILING.

A. On June 16, 2021, PWR filed this rate increase request that seeks to increase annual jurisdictional revenues by $499,003, or 13.72%, over its test year revenues. This increase reflects an overall rate of return on rate base of 8.08 percent and a 10.95 percent return on equity for the historical test year (HTY) ended December 31, 2020. According to the Company, the financial data on which its current rates are based is now nearly three years old, based on the date of its last rate case. Since then, the Company claims it has invested approximately $2 million in capital improvements to its wastewater facilities. Therefore, PWR believes that a rate increase is necessary for the company to provide reasonable and adequate service to its customers, cover its expenses, be permitted an opportunity to earn a reasonable return on its investment, and attract capital for future improvements.

Q. WHAT TIME PERIOD HAVE YOU USED IN MAKING YOUR DETERMINATION OF PWR'S REVENUE REQUIREMENTS?

A. Consistent with PWR's filing, I have used the HTY ended December 31, 2020 as the basis for determining PWR's test year revenue requirements.

Q. HOW IS THE REMAINDER OF YOUR TESTIMONY ORGANIZED?

A. The remainder of my testimony documents and explains each of the adjustments to rate base and operating income that I have made to arrive at the test year revenue increase shown on Exhibit 1-Schedule LKM-1. My discussion of these adjustments is organized into sections corresponding to the issue being addressed. I then address and discuss my recommendation for the Company's proposal to increase the tampering charge to an amount not to exceed $500. The intent of the tampering charge is to pass through the actual cost incurred by the Company to repair damage by a customer who damages or tampers with utility property. These sections are also outlined in the Table of Contents for this testimony.

Q. PLEASE SUMMARIZE YOUR FINDINGS AND RECOMMENDATIONS.

Based on Mr. Rothschild's recommendation and my analysis, as summarized on Exhibit 1-Schedule LKM-1, the Company's cost of service supports a revenue decrease of $370,405. This is the amount by which revenues exceed those required to generate an overall rate of return of 5.22 percent, as recommended by Mr. Rothschild, after accounting for my adjustments to PWR's claimed rate base and operating income presented in this testimony. This represents a decrease of $869,408 from PWR's requested increase of $499,003. At a minimum, my analysis demonstrates that no rate increase is justified.

Regarding the tampering charge, I am recommending that the Commission not allow the establishment of the proposed $500 charge. Instead, I am recommending it remain a $250 charge.

III. ADJUSTMENTS TO THE COST OF SERVICE

A. Billed Revenues

Q. PLEASE EXPLAIN THE ADJUSTMENT YOU ARE RECOMMENDING TO BILLED REVENUES.

A. In Pro Forma Adjusting Entry #1 in PWR's filing, the Company makes an adjustment to increase billed revenues by $110,933 to annualize revenues based on the 8,006 Equivalent Residential Connections ("ERC") as of December 31, 2020. It appears the Company's rationale for the adjustment is to reflect the billed revenues at year-end levels. However, the Company has adjusted rate base to reflect post-test year plant additions by including plant additions through March 2021. The Company's application and testimony do not explain why the post-test year plant additions were included in rate base. However, from my review of other rate cases before the Commission, I understand that the Commission has previously allowed the inclusion of post-test year plant in rate base.

Because of the inclusion of post-test year plant in service, I am recommending an adjustment to annualize revenues based upon the number of ERCs as of April 30, 2021. As of that date, the Company shows that there were 8,043 ERCs, which I have used to annualize billed revenues. I have used the 8,043 ERCs for two reasons. First, because of the inclusion of the post-test year plant in service in rate base, there is a mismatch between operating revenues and rate base. I use the 8,043 ERCs to reflect the customers who would be served by the post-test year plant in service. The second reason for using the 8,043 ERCs is that it reflects a reasonable number of connections/customers that the Company believes would be served by the post-test year plant additions. In the response to DCA 3-24(c), the Company stated: "[t]he 12/31/21 customers and ERCs are based on the customer and ERCs as of April 2021." See Exhibit 2. In response to ORS 3-6, the company indicated it had 8,043 ERCs as of April 2021. See Exhibit 3. Hence, I have used the 8,043 ERCs as a number to project revenues relating to the customers that would be served by the post-test year plant in service.

Therefore, on Exhibit 1-Schedule LKM-4, I present my adjustment to increase billed revenue by $16,836.

B. Other Wastewater Revenues

Q. PLEASE EXPLAIN THE ADJUSTMENT YOU ARE RECOMMENDING TO OTHER WASTEWATER REVENUE.

A. Other Wastewater Revenue is composed of Notification Fees, Late Fees, Returned Check Fees, Reconnect Fees, and New Account Processing Fees. The level of Other

Wastewater Revenue included in the Company's cost of service for the test year is significantly lower than the two previous years. The test year, the 12 months ended December 2020, was a very unusual year because of the impact of the COVID-19 pandemic. During the month of March 2020, the Commission directed the suspension of disconnection of all regulated utility customers for non-payment and all non-payment related fees during the State of Emergency declared by the Governor. During this period, there was an increase in the level of unemployment and a decrease in business activity nationwide. In fact, in the response to ORS 6-5, the Company acknowledges the impact of the pandemic on the collectability of its receivables. In that response, the Company states:

> With the impact to the ultimate collectability of the increased receivables during the COVID-19 pandemic still unknown, the company continued to reserve on delinquent accounts but did not write-off any delinquent accounts as bad debt during 2020.

See Exhibit 4. With a restriction on the Company's ability to collect delinquent accounts or impose penalties for non-payment, quite naturally the revenues captured in this account during 2020 would fall.

I am recommending an adjustment to normalize the level of Other Wastewater Revenue to avoid an understatement of revenues. I have based my adjustment on the average Other Wastewater Revenues for the two years prior to the test year. This result in an adjustment that increases Other Wastewater Revenues by $17,480 as presented on Exhibit 1-Schedule LKM-5.

C. Rate Case Expense

Q. WHAT ADJUSTMENT HAVE YOU MADE TO RATE CASE EXPENSE?

A. In Pro Forma Adjusting Entry #8, the Company makes its rate case expense claim. The Company has determined its rate case expense claim based upon two components of costs. First, the Company includes $26,667 for unrecovered rate case expense related to the last rate case proceeding, Docket No. 2018-82-S. Then, the company includes an estimated $160,000 for costs related to this proceeding. The total amount of $186,667 is then amortized over a 2-year period to derive the annualized rate case expense claim.

I have made two changes to derive my adjustment to rate case expense. First, I have removed the $26,667 related to the previous rate case. The Company admits in the response to DCA 3-14, that there are four months of amortization remaining on the 2-year amortization allowed in the last rate case. See Exhibit 5. I have removed this amount because those costs will be recovered by the time rates in this proceeding become effective. Therefore, there is no need to include them in the cost of service.

The second change I have made is to use a 3-year period to amortize the rate case expenses related to this proceeding. The 3-year period is based upon the approximate time between the last rate proceeding and this proceeding.

Based upon the two changes described above, I am recommending an adjustment that decreases rate case expense by $40,007 as presented on Exhibit 1-Schedule LKM-6. In deriving my adjustment, I have used the estimated expense presented by the Company. However, it should be noted that in the response to DCA 3-13, the Company indicated that it would update the estimated expense to actuals later in this proceeding. I request that the Company provide an update of the rate case expenses incurred to date in its rebuttal testimony.

D. Shared Corporate Expenses

Q. WHAT ARE SHARED CORPORATE EXPENSES?

A. For companies that are part of a multi-company ownership group, shared corporate services expenses are indirect expenses that are incurred by the parent company, or a shared services affiliate, that benefit the companies in the ownership group. These shared corporate costs generally relate to the following functions: 1) executive management; 2) legal; 3) information technology services; 4) human resources; 5) facilities management; and 6) finance and accounting. The rationale for the shared services structure is that operating costs are higher if the various functions are performed by each affiliate or business unit. The shared services structure allows the functions to be performed in a consistent manner from affiliate to affiliate and is more cost effective because of economies of scale.

Q. WHAT IS PWR'S OWNERSHIP GROUP?

A. PWR is a subsidiary of SouthWest Water Company ("SWWC").

Q. WAS PWR FOUNDED AS A SUBSIDIARY OF SWWC?

A. No. On September 14, 2020, SWWC announced that its wholly owned subsidiary, South Carolina Utility Systems, Inc. acquired the South Carolina wastewater utility operations of Ni Pacolet Milliken Utilities from Pacolet Milliken, LLC. PWR. is one of the utility companies owned by Ni Pacolet Milliken Utilities.See Exhibit 6.[1]

Q. HOW IS THE CHANGE IN OWNERSHIP GERMANE TO THE LEVEL OF CORPORATE SHARED SERVICES EXPENSES?

A. Because the change in ownership occurred during the test year, the level of shared corporate costs is derived from two separate parent company groups. By combining the costs from the two corporate parent companies that owned PWR during the test year, the Company is attempting to present the combined costs as reflective of the normal annual operating costs.

First, the Company presents $746,265 of shared costs allocated from Ni Pacolet Milliken Utilities and SWWC. See Exhibit 7. [2] These costs are described as regional and local shared costs. From reviewing these costs, they appear to be made up of the

[1] Also available at- https://www.swwc.com/southwest-water-company-announces-acquisition-of-ni-pacolet-millikens-utilities/
[2] PWR response to ORS AIR 1-3, Att g - PWR Shared Costs Detail and Allocation.xlsx

day-to-day operating costs of the Company, although they contain some general corporate overheads. For instance, the following are accounts included in the $746,265: 1) Ni OPS Depreciation expense; 2) Ni OPS Labor-related expense; 3) Ni OPS Bonuses; and 4) Overhead Allocated to Subs. Ni OPS is the abbreviated reference for Ni America Operating, Inc. According to the data reviewed, these costs appear to be composed of charges that were incurred under Ni Pacolet Milliken Utilities ownership (charged from Ni OPS) through the middle of September 2020 and charges from SWWC from the middle of September 2020 to December 31, 2020.

The second set of costs added by the Company appear to be corporate management overhead costs of $208,774 charged from SWWC.[3] The total amount included in this charge represents SWWC management costs that were incurred during the entire year of 2020. The Company then adds this $208,774 of management costs incurred by SWWC to the regional and local shared costs of $746,265 to derive the total allocated corporate costs of $955,039.

In my opinion, the aggregated costs, as presented by the Company, are not reflective of the normal ongoing annual costs to be incurred under the new ownership. This is because the costs, as presented, were incurred before full integration of the two corporate entities. As a result, there may be costs incurred under the previous ownership and reflected in the shared costs that would be eliminated once full integration of the two companies occur. For example, the total allocated shared costs presented in the filing includes corporate charges from NI OPS that includes costs related to corporate executives. Those allocated shared costs also include the shared corporate costs from SWWC that is also comprised of corporate executives' costs. Under full integration, there will only be one set of corporate executive costs, not two as presented by the

[3] Company Filing Exhibit B, Schedule B., Adjusting Entry 10.

Company. The chart below summarizes some of the shared services costs that were allocated to PWR but are likely to be eliminated when the two companies are fully integrated.

Palmetto Shared Services Costs Under Previous Ownership	
Description	Amount
Allocated Depreciation Expense	$ 34,062
Overhead Allocated to Subs	1,564,735
Executive Bonuses	523,447
Contractual Svcs - Accounting	183,500
Computer Consulting	38,155
Total	$ 2,343,898

Data Source: PWR response to ORS AIR 1-3 Att g - PWR Shared Costs Detail and Allocation

Q. WHAT ADJUSTMENTS ARE YOU RECOMMENDING TO CORPORATE SHARED SERVICES EXPENSE?

A. I am recommending two adjustments to shared services expense. First, I am recommending a removal of the $208,774 of shared costs allocated by SWWC to PWR in Pro Forma Adjusting Entry #10. I have removed these costs because they are an allocation of SWWC's shared costs for the entire calendar year 2020. Since PWR was not under SWWC ownership for the entire year, it did not receive any of the benefits of these costs. Therefore, I believe it is inappropriate to include them in the cost of service. I also believe that it is inappropriate to include these costs in operating expenses because, as I have explained above, it would not reflect a normal ongoing level of shared services costs. One of the fundamental principles of utility ratemaking is that expenses should reflect the normal annual level of ongoing expenses. The Company's claim does not abide by that principle.

Q. WHAT IS THE OTHER ADJUSTMENT YOU RECOMMEND TO SHARED CORPORATE EXPENSES?

A. As part of the labor costs included in the cost of service, the Company included costs that were paid related to a "stay bonus" in September 2020[4] around the time the SWWC acquisition of Ni Pacolet Milliken Utilities. This cost appears to be bonus paid to an employee(s) to remain with the Company for a period of time after the acquisition. As such, they are one-time costs that should be removed because they are not reflective of normal ongoing costs. Therefore, in my adjustment, I recommend the removal of $62,113 to eliminate the inclusion of the one-time costs as summarized below.

Summary of Non-Recurring Bonus		
Distribution Reference	Description	Amount
Acr 09-18-20 Stay Bonus Ni OPS	Bonus	$ 352,385
Acr 09-18-20 Stay Bonus Ni OPS	Emp Ben - Employer Retirement Contr Match	15,974
Sep 15 NQ 401k CO Match	Employer Non-Qualified Ret Contribution Match	98
Acr 09-18-20 Stay Bonus Ni OPS	Employer Non-Qualified Ret Contribution Match	1,481
	Total	369,938
	Allocation Factor	16.79%
	Adjustment	$ 62,113
Data Source: PWR response to ORS AIR 1-3 Att g - PWR Shared Costs Detail and Allocation		

Q. PLEASE SUMMARIZE THE ADJUSTMENT YOU RECOMMEND TO SHARED CORPORATE EXPENSES?

A. As presented on Exhibit 1-Schedule LKM-7, I have combined my adjustments resulting in a total adjustment which reduces O&M expenses by $270,887.

E. Employee Benefits Expense

Q. WHAT ADJUSTMENT HAVE YOU MADE TO EMPLOYEE BENEFITS EXPENSE?

A. The employee benefits expense for the test year is significantly higher than the two previous years. The Company explains that it does not have employees, and that the labor costs are based on costs allocated through shared services costs. See Exhibit 8.

[4] See Exhibit 7 ORS AIR 1-3 Att g - PWR Shared Costs Detail and Allocation.xlsx, Excel.

As I have explained earlier, the aggregated shared services costs presented by the Company does not portray a reasonable level of allocated costs. In this instance, the employee benefits expense presented by the Company may be overstated. Therefore, I am recommending an adjustment to normalize employee benefits costs to reflect the most recent 3-year average. On Exhibit 1-Schedule LKM-8, I present this adjustment which reduces O&M expenses by $51,340.

F. Depreciation Expense

Q. HOW HAS PWR DETERMINED ITS CLAIMED TEST YEAR DEPRECIATION EXPENSE?

A. The depreciation expense included in the cost of service is composed of the depreciation on the utility plant in service of $656,001 and an allocation of $36,206 of corporate depreciation expense from SWWC.[5] As I explained earlier, the corporate shared costs are a combination of the shared costs from two separate corporate entities which results in a misstatement of the allocated shared costs. The allocation of the $36,206 of corporate depreciation expense is additional corporate shared costs from SWWC that are being charge to PWR. Consistent with the adjustment I have made to remove shared costs allocated from SWWC, I am recommending an adjustment to also remove the depreciation charges from the cost of service. On Exhibit 1-Schedule LKM-9, I present my adjustment to reduce depreciation expense by $36,206.

G. Allowance for Cash Working Capital

Q. PLEASE EXPLAIN YOUR ADJUSTMENT TO CASH WORKING CAPITAL.

A. The Company has used the formula method to determine its cash working capital allowance. This formula is based upon 1/8th of O&M expenses. Since I have made certain adjustments to O&M expenses, the level of cash working capital must be

[5] See Exhibit 9. Response to ORS AIR 3-1 Att e - Depreciation Expense

adjusted to be consistent with the level of O&M expenses that I am recommending. Therefore, on Exhibit 1-Schedule LKM-10, I present this adjustment which reduces cash working capital by $45,279.

H. Interest Synchronization

Q. PLEASE EXPLAIN YOUR INTEREST SYNCHRONIZATION ADJUSTMENT.

A. To determine the tax-deductible interest for ratemaking, I have multiplied my recommended rate base by the weighted cost of debt included in the capital structure recommended by DCA witness Rothschild. This procedure synchronizes the interest deduction for tax purposes with the interest component of the return on rate base to be recovered from ratepayers. As shown at the bottom of Exhibit 1-Schedule LKM-11 this adjustment increases the interest deduction by $10,891 compared to the interest deduction recognized by PWR. This decreases state and federal income taxes by $545 and $2,173, respectively.

IV. TAMPERING FEE

Q. PLEASE EXPLAIN THE COMPANY'S PROPOSED TAMPERING FEE.

A. The Company proposed a $500 tampering charge applicable to customers that cause damage to the company's property. As requested by the Company, in the event its equipment, mains, service lines, elder valves, or other plant or facilities have been damaged or tampered with by a customer, PWR may charge the customer responsible for the damage the actual cost, up to $500, of repairing the equipment, plant or facilities. The Company proposes that the tampering charge shall be paid in full before it reconnects service or continues the provision of service.

Tampering and damage to the Company's property is not a pervasive problem. In response to a DCA discovery, the Company could only show one instance "involving tampering, damage or vandalism for the 2018 through 2021". In that one instance, the company declined to press charges against the customer. [6] Part of the Company's justification for proposing this charge is that another utility in South Carolina is authorized to charge this fee. This is not a valid justification.

In PWR's last rate case, Docket 2018-82-S, and one of its affiliates in Docket No. 2019-281-S, the Commission approved a tampering charge. In those proceedings, the Commission authorized a fee not to exceed $250. The Company has failed to demonstrate that tampering and damage to its property is a pervasive problem. Therefore, an increase in the fee is not necessary at this time.

Q. PLEASE SUMMARIZE YOUR FINDINGS AND RECOMMENDATIONS.

A. My analysis of PWR's cost of service shows the Company's current annualized revenue of $3,695,050 (after reflecting the DCA's adjustments) should be reduced by $370,405 in order to attain the overall rate of return on rate base of 5.22 percent as recommended by DCA witness Rothschild. If the Commission is not inclined to reduce the Company's revenue, it should deny the requested increase as my analysis shows the current revenue is more than sufficient.

Q. DOES THIS COMPLETE YOUR DIRECT TESTIMONY?

A. Yes, it does.

[6] See Exhibit 10. Response to DCA AIR 3-3. The Company's attachment to this response was identified as "confidential" due to the inclusion of customer information.